IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-647

THE STATE OF NEW YORK and the NEW YORK STATE HOUSING FINANCE AGENCY
Petitioners,

against

MILTON FORMAN and ELLEN FORMAN, et al.,
Respondents,

and

UNITED HOUSING FOUNDATION, INC., et al.,
Additional-Respondents.

ON CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE STATE OF OHIO, AMICUS CURIAE

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INTRODUCTION

This case is before the Court on certiorari to the Second Circuit Court of Appeals. That court had reversed a jurisdictional dismissal entered in the district court.

Ohio is concerned with the almost offhand holding by the Second Circuit that New York had either explicitly or implicitly waived its immunity to suit in federal court as to asserted violations of the federal securities laws. It

was to contest this holding that Ohio supported New York's petition for writ of certiorai.

Both Judge Pierce in the district court and Judge Oakes for the Court of Appeals have written learned opinions on the question whether shares in a non-profit cooperative housing corporation are securities within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. Ohio expresses no opinion on that question, although a holding that such shares are not securities will be dispositive of this case.[1]

Ohio wishes to focus on the Second Circuit's theory of implicit waiver of Eleventh Amendment immunity by New York. The Second Circuit stated its theory in this way:

> "Secondly, the State has waived its sovereign immunity with respect to federal securities laws violations by voluntarily entering a field under federal regulation. See *Parden* v. *Terminal Railway of Alabama Docks Department*, 377 U.S. 184, 84 S. Ct. 1207, 12 L. Ed. 2d 233 (1964) . . . by enacting the federal securities laws in the exercise of the Commerce Clause – a power given to the federal government by the states in adopting and ratifying the constitution – the Congress conditioned the right to be involved in the sale and distribution of securities upon amenability to suit in federal court as provided by those regulatory laws." 500 F. 2d 1246 at 1256.

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[1] The Second Circuit's holding on Eleventh Amendment immunity was in the alternative. The Court found explicit waiver in Section 32(5) of the Mitchell-Lama Act under which the State regulates cooperatives of the type involved in this litigation, *Forman* v. *Community Services, Inc.*, 500 F. 2d 1246 at 1256. New York vigorously denies that Section 32(5) has the effect attributed to it by the Court of Appeals. (Petition of New York at 12-13.) Ohio will not argue this explicit waiver theory. New York's grounds for opposing it are compelling.

More succinctly, the Court argues that Congress, exercising the Commerce Power in adopting the 1933 and 1934 Acts, required States to waive their Eleventh Amendment immunity as the condition of concurrently regulating the issuance and sale of securities.

The enormous implications of adopting that theory have already been argued by Ohio in its Amicus Brief in Support of the Petition for Writ of Certiorari (pp. 2-3). The decision would make States target defendants in virtually all stock fraud litigation, since every State is involved in some form of securities regulation. Ohio has twice been sued in federal court in the last eighteen months on the Second Circuit's theory of implied Eleventh Amendment waiver, *Devoe* v. *Ostrander,* Civ. No. C 3 74-95 (S.D. Ohio); and *Yeomans* v. *Department of Banking and Securities,* No. 74-2003 (6th Cir., appeal pending).

Furthermore, the theory would threaten the whole pattern of cooperative and concurrent regulation by the States and federal government which is really the prevalent mode of modern economic regulation. Vast areas of federal regulation are founded, constitutionally, on the Commerce Clause. The opinion below would effectively exclude the States from all of those areas. Logically, the Second Circuit's theory implies that States may concurrently regulate any of those areas only by surrendering their Eleventh Amendment immunity. To permit the States to be sued under federal statute in every area in which they are co-regulators would expose them to virtually unlimited liability or drive them out of concurrent regulation. Adoption of the theory would thus threaten the exercise in fact, because of the price imposed, of the power preserved to the States by this Court in *Cooley* v. *Board of Wardens of the Port of Philadelphia,* 12 How. 299 (1851) and zealously protected ever since.

That a legal theory has unacceptable consequences is of course good grounds for rejecting it. But there are more compelling grounds for rejecting the Second Circuit's implied waiver theory in this case. It has already been implicitly rejected by this Court's decisions in *Employees of the Department of Public Health & Welfare* v. *Department of Public Health & Welfare,* 411 U.S. 279 (1973); and *Edelman* v. *Jordan,* —— U.S. ——, 39 L. Ed 2d 662 (adv. sheets) (1974). Those decisions represent a concentrated effort by this Court in its last two terms to establish guidelines for judging asserted implicit waivers of Eleventh Amendment immunity. But the Second Circuit opinion being reviewed totally ignores the *Edelman* decision and attempts an extremely wooden and unconvincing distinction of *Employees.* Furthermore, it conflicts with the decision of every other federal court which has considered the implicit waiver theory advanced by Plaintiffs here. Thus, it threatens seriously to undermine the constitutional decision of this Court in *Employees, supra,* and *Edelman, supra,* as well as the work of the other federal courts which have carefully followed those decisions. See *Devoe* v. *Ostrander, supra* (decision of October 18, 1974); *Yeomans* v. *Department of Banking and Securities, supra* (dismissed sub. nom. *Mathews* v. *Fisher,* Civ. No. 8482 S. D. Ohio 1974); *Brown* v. *Commonwealth of Kentucky,* No. 74-1347 (6th Cir. appeal pending); *MacKethan* v. *Commonwealth of Virginia,* 370 F. Supp. 1 (E. D. Va. 1974).

ARGUMENT

Summary

The Second Circuit's theory of implicit waiver of Eleventh Amendment immunity, quoted above, should be rejected because it conflicts with this Court's decisions in *Edelman* v. *Jordan, supra,* and *Employees* v. *Missouri Public Health Department, supra.*

Specifically, in order to find an implicit waiver of Eleventh Amendment immunity, *Edelman* requires the existence of specific explicit Congressional authorization in the statute in question to sue a class of defendants which literally includes States; no such Congressional authorization can be found in either the Securities Act of 1933 or the Securities Exchange Act of 1934 (the "1933 Act" and the "1934 Act," respectively). Furthermore, *Employees* requires a finding of congressional intention to require states to waive their Eleventh Amendment immunity by doing some voluntary, proprietary act under the legislation in question and voluntary performance of that act by the State being sued. Nothing in the legislative history of either the 1933 or the 1934 Act supports such a finding in this case.

A. EDELMAN v. JORDAN, SUPRA, PRECLUDES FEDERAL COURT JURISDICTION OF THIS ACTION: CONGRESS HAS NOT AUTHORIZED SUIT FOR VIOLATIONS OF THE 1933 AND 1934 ACTS AGAINST A CLASS OF DEFENDANTS WHICH LITERALLY INCLUDES THE STATES.

This action, as originally brought, alleged violations of the anti-fraud provisions of the 1933 Act (15 U.S.C. §

77q (a)), and the 1934 Act and Rule 10b-5 under the 1934 Act (15 U.S.C. § 78j and 17 CFR 240-10b-5, respectively). *Forman* v. *Community Services, Inc.*, 366 F. Supp. 1117, 1120 (S.D. N.Y. 1973).

In terms, the Eleventh Amendment to the United States Constitution bars this suit and all others seeking relief against a State in federal court. The Amendment provides:

> "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens or Subjects of any Foreign State."

Here, suit is brought by citizens of New York against their own State of residence, but the Amendment has been held constitutionally to bar suits by a citizen against his own State of residence as well as against other States, *Hans* v. *Louisiana*, 134 U.S. 1 (1890); *Employees* v. *Missouri Public Health Department, supra*; *Jordon* v. *Gilligan*, 500 F. 2d 701 (6th Cir. 1974); *Dawkins* v. *Craig*, 483 F. 2d 1191 (4th Cir. 1973).

A State may, of course, waive the protection of the Eleventh Amendment. Congress, in regulating interstate commerce, may explicitly require States to waive this immunity as a condition of participating in activities regulated by the federal government, *Parden* v. *Terminal Ry.*, 377 U.S. 184 (1964). *Parden* is the sole authority relied upon by the Second Circuit below; indeed, it states its conclusion of law as a paraphrase of *Parden*.

Parden is, of course, only one of a long line of decisions of this Court on Eleventh Amendment immunity. Furthermore, the statute in question in *Parden* satisfied the test of implicit waiver as set forth in *Edelman*. Justice Rehnquist formulated that test as follows:

> "But in this case the threshold fact of congressional authorization to sue a class of defendants which literally includes states is wholly absent." *Edelman, supra,* at 678.

The instant case fails to satisfy the *Edelman* test for there is no authorization in the 1933 Act or the 1934 Act to sue a class of defendants which literally includes the States.

Suit under the 1933 Act in this case is premised upon its anti-fraud provisions, Section 17 (a) (15 U.S.C. § 77q (a)). The 1933 Act does not authorize suit by a private party against *any* defendant with respect to the provisions of Section 17 (a). Section 17 literally says that "it shall be unlawful for any person" to engage in certain fraudulent activities. Section 20 gives the Securities and Exchange Commission authority to apply to a court for an injunction against "violations" of the Act. The same section empowers the attorney general "in his discretion [to] institute the necessary criminal proceedings under this subchapter." Section 24 makes "willful violations" criminal offenses.

But the sections of the 1933 Act which are intended by Congress to be privately enforced speak of "liabilities" rather than "violations." For example, Section 11 (15 U.S.C. § 77k) refers specifically to civil liabilities on account of false registration statements. Section 21 (15 U.S.C. § 77l) refers to civil liabilities arising in connection with prospectuses and communications. Section 15 (15 U.S.C. § 77o) defines the "liability of controlling persons." The statute preserves the distinction between liabilities and offenses or violations in the jurisdictional section, Section 22 (15 U.S.C. § 77v), which provides in subsection (a):

> "The district courts of the United States . . . shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all

> suits in equity and actions at law brought to enforce any liability or duty created by this subchapter."

Congress, then, as is evident from the very words of the statute, did not create a cause of action under Section 17 against a class of defendants which literally includes the States.

Some courts have implied a private right of action for violations of Section 17 (a), see, e.g., *Mader* v. *Armel*, 402 F. 2d 158 (6th Cir. 1968). But Mr. Justice Rehnquist's opinion for the Court in *Edelman* makes it clear that an *implied* private right of action will not satisfy the threshold test:

> "While this Court has, in cases such as *Case* v. *Borak*, 377 U.S. 426, 12 L. Ed. 2d 423, 84 S. Ct. 1555 (1964), authorized suit by one private party against another in order to effectuate a statutory purpose, it has never done so in the context of the Eleventh Amendment and a state defendant." *Edelman, supra*, at 679.

What is true for Section 17 (a) of the 1933 Act is likewise true for Section 10b of the 1934 Act. Here also Congress created no explicit private right of action. Indeed the draftsmen employed the same grammatical construction used in Section 17 (a): "It shall be unlawful for any person, . . ." to engage in certain acts. Here also Congress intended the statute to be enforced by the Securities and Exchange Commission. The development of private rights of action by implication under Section 10b is more firmly established than that under 17 (a). But the same principle applies — an implied private right of action will not meet the threshold test of literal inclusion set forth in *Edelman*.

The Second Circuit's implied waiver theory thus fails to meet even the threshold test imposed by this Court in

Edelman. Accordingly, the Court of Appeals should be reversed on this ground alone.

B. CONGRESS NEVER INTENDED TO REQUIRE WAIVER OF ELEVENTH AMENDMENT IMMUNITY AS A CONDITION OF A STATE'S ENGAGING IN THE CONCURRENT REGULATION OF SECURITIES.

Beyond the threshold test of *Edelman*, a theory of implicit waiver of Eleventh Amendment immunity must satisfy the requirements of this Court's *Employees* decision. Advocates of any such theory must prove that Congress intended to require waiver of Eleventh Amendment immunity as a condition of a State's participating in the particular regulated federal activity.

> "The question of waiver or consent under the Eleventh Amendment was found in those cases [*Employees, supra, Parden, supra,* and *Petty* v. *Tennessee-Missouri Bridge Comm'n,* 359 U.S. 275 (1959)] to turn on whether Congress has intended to abrogate the immunity in question, and whether the State, by its participation in the program authorized by Congress, had in effect consented to the abrogation of that immunity." *Edelman, supra,* at 678.

Evidence of such congressional intent must be very strong, since "constructive consent is not a doctrine commonly associated with the surrender of constitutional rights. . . ." *Id.* Thus, this Court forcefully reminded the lower federal courts that it is a constitutional immunity which is in question; an explicit abrogation is required:

> ". . . we will find waiver only where stated 'by the most express language or by such overwhelming implications from the text as will leave no room for any other reasonable construction.' *Murray* v. *Wilson Dis-*

tilling Co., 213 U.S. 151, 171, 53 L. Ed. 742, 29 S. Ct. 458 (1909)." *Id.*

The Second Circuit's theory here is that when New York undertook concurrent regulation of securities, by that act it voluntarily waived its Eleventh Amendment immunity. Implicitly, the Court below holds Congress intended that result.

The Second Circuit theory, when measured against the strict test of *Employees,* fails utterly to convince one of its soundness. The evidence of Congressional intent, far from supporting the Court below, points strongly against any waiver.

In the first place, in adopting both the 1933 and 1934 Acts, Congress very carefully preserved the concurrent regulatory jurisdiction of the States. Section 18 of the 1933 Act provides:

> "Nothing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person." (15 U.S.C. § 77r).

Section 28 of the 1934 Act is nearly identical:

> ". . . Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." (15 U.S.C. § 78bb).

It is peculiar reasoning which asserts that Congress, having so carefully protected the States' securities jurisdiction, intended to condition exercise of that jurisdiction on surrender of Eleventh Amendment immunity. The argument

depends on attributing a certain perverseness to the Congressional mind of the times.

Judge Oakes claimed to find conclusive support for the Second Circuit's theory in the legislative history of the 1933 Act. He argued:

> "Were there any doubt that the securities laws were intended to reach the states or their agencies, the legislative history dispels it. *See* H. R. Rep. No. 85, 73d Cong., 1st Sess. 11." *Forman, supra,* at 1257

The language to which Judge Oakes apparently has reference to is as follows:

> "Paragraph (2) [of Section 2 of the 1933 Act] defines 'person' in terms sufficiently broad to include within that conception not only an individual, but also every form of commercial organization that may issue securities. It includes within the concept of 'person' a government or a political subdivision thereof, although later sections of the bill exempt from its provisions securities issued by the United States, a State, or a Territory, or a political subdivision of any of these governmental units." H. R. Rep. No. 85, 73d Cong., 1st Sess., 11.

The very language cited indicates that State and subdivision securities were exempted by a later section of the 1933 Act, despite the breadth of the word "person." (Section 3 (a) (2), 15 U.S.C. § 77c (a) (2)).

Why was "person" defined so broadly in the 1933 Act in the first place? Not to permit a private action like the present one, under Section 17 (a) against a State, for the Act authorizes no private actions under Section 17 (a) at all. (See Argument, *supra* at 7). The answer is found in examining what governmental securities there are, other than those of the United States, States, and policical subdivisions. Securities of foreign governments had been

widely touted by the Wall Street brokerage firms in the late twenties. Investors had been hurt badly by defaults on these issues. James M. Landis, principal draftsman of the 1933 Act, points out that Congress was anxious to extend the Act's protections to Americans buying foreign government securities; it was for this reason that Section 2 (2) was drafted so broadly. Landis, "The Legislative History of the Securities Act of 1933," 28 Geo. Wash. L. R. 29 at 42.

Thus the sole reference in the legislative history to which Judge Oakes points in fact proves States were exempted. The same report notes a page earlier that: "The bill carefully preserves the jurisdiction of State security commissions to regulate transactions within their own borders." H. R. Rep. No. 85, 73d Cong., 1st Sess., 10.

While Judge Oakes' argument from the legislative history proves too little, it also proves too much, for this case is brought under the 1934 Act as well as under the 1933 Act. If a broad definition of "person" in the 1933 Act were significant, then the much narrower 1934 Act definition, which includes no governmental entities at all, must also be significant. That definition, found in Section 3 (15 U.S.C. § 78c (9)) is as follows:

> "(9) The term 'person' means an individual, a corporation, a partnership, an association, a joint-stock company, a busines trust, or an unincorporated organization."

Even if the 1933 and 1934 Acts reached securities *issued by* States and even if it were shown that Congress intended to subject States to federal court jurisdiction for violations of the Acts in the *issuance* of securities, that would not prove the waiver theory of the Court below. Issuance of securities is a proprietary function of States, in that it is an

activity which can be, and most frequently is, carried on by commercial entities. But the Second Circuit asserts a waiver here arising out of New York's *regulation* of securities. As pointed out below, this Court has refused to find Congressional intention to require waiver where a State function is governmental — as regulation certainly is — as opposed to where it is proprietary. Compare *Parden, supra,* with *Employees, supra.* Judge Oakes' argument from the text and legislative history is just not convincing.

For case authority, the Court below relied exclusively on *Parden* v. *Terminal Ry., supra,* where this Court found implicit waiver by State operation of a railroad after the FELA had been amended so as to apply, literally at least, to States. In *Parden* there was at least a statute satisfying the *Edelman* threshold test, which is not the case here. (See Argument, *supra,* at 7). More importantly, *Parden* involved a purely proprietary activity by Alabama, one which is normally conducted in our economy by private persons for profit, *Employees, supra,* at 256. In *Employees,* the operation of hospitals for the mentally ill was carefully distinguished from railroad operation. Justice Douglas pointed out that, while some hospitals were run by private persons, hospitals dealing with mental problems had been largely a governmental enterprise from the earliest days of the Republic. *Id.*

Employees should be a harder case for this Court than the instant one. The ownership and operation of hospitals is at least an activity which conceptually can be done by private individuals. In the instant case, the Second Circuit seeks to find a waiver of immunity in exercise by New York of a purely governmental function, the regulation of the issuance of securities. A more strictly governmental function can scarcely be imagined.

In a thoughtful opinion on the issue before this Court,

Judge Merhige, of the Eastern District of Virginia, decided that State regulation of securities was much more clearly governmental even than the operation of hospitals. Faced with the same theory advanced by the Second Circuit here, he concluded:

> "Plaintiff now attempts to extend the *Parden* doctrine into the area of pure governmental regulation. Such efforts, in the Court's view, must fail. The impetus of the Employees rationale is stronger here than in the case in which it was announced. While the operation of hospitals is not necessarily a governmental function, the specific nature of the hospitals involved in *Employees* gave State activity in that area a traditional basis. In the present context the State activity attacked is necessarily of a governmental nature. Regulation of securities is not an endeavor in which private persons are free to participate." *MacKethan* v. *Commonwealth of Virginia,* 370 F. Supp. 1 at 4 (E. D. Va. 1974); affirmed *per curiam* No. 74-1249 (4th Cir. December 23, 1974)

The Second Circuit's attempt to distinguish *Employees* is completely unconvincing. At Footnote 13, they argue the State activity in *Employees* came before adoption of the federal statute which purportedly required the surrender of immunity. In *Parden,* the federal statute came first and state operation of the railroad later. The Second Circuit asserts that the same is true for securities regulation. It may be that New York's regulation of cooperative housing securities came after the 1933 and 1934 Acts were adopted. But most States regulated at least some securities prior to 1933. If the Second Circuit's theory were adopted, along with its distinction of *Employees,* States' regulation adopted after 1933 or 1934 would subject them to federal court suits whereas regulations adopted before that would not. That would make absolutely no sense. In any event,

this Court did not rely on that distinction in *Employees*.

The Second Circuit's implied waiver theory finds no support in the text or legislative history of the Acts or in this Court's decisions. It should be rejected.

CONCLUSION

The Eleventh Amendment was adopted to protect the fiscal integrity of the States from money judgments in federal court, 1 *History of the Supreme Court of the United States* (Goebel) 736-42. That purpose has continued to inspire the decisions of this Court, most recently in *Employees* and *Edelman*. If the Second Circuit decision in this case is allowed to stand, it will threaten that purpose and this Court's recent work to protect it. The decision below should be reversed.

Respectfully submitted,

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